Nos. 95-966, 95-977

In The

Supreme Court of the United States

October Term, 1995

KEVIN M. O'GILVIE and STEPHANIE L. O'GILVIE, minors,

Petitioners,

-and-

KELLY M. O'GILVIE,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR PETITIONER KELLY M. O'GILVIE

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Tenth Circuit Court of Appeals in its decision in *O'Gilvie v. United States*, 95-2 USTC ¶ 50,508 (10th Cir. 1995) has interpreted a federal statute in a manner that unreasonably limits enforcement of legislative intent and inpermissibly mandates a finding in favor of the government.

2. Whether a punitive damages award received in a suit involving physical injury is excludable from gross income as "any damages . . . received on account of personal injuries. . . ." 26 U.S.C. § 104(a)(2).

3. Whether the federal district court is required to strictly comply with Federal Rules of Civil Procedure in order to modify its judgments or has power independent of the Federal Rules to modify its judgment.

LIST OF ALL PARTIES TO THE PROCEEDINGS

Parties are Kelly M. O'Gilvie, Petitioner, case number 95-977; Kevin M. O'Gilvie and Stephanie L. O'Gilvie, case number 95-966.

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OPINION BELOW

The opinion of the Court of Appeals for the Tenth Circuit in *O'Gilvie v. United States* is reported at 66 F.3d 1550 (10th Cir. 1995), 95-2 USTC ¶ 50,508, and is reprinted in the Petition for Writ of Certiorari appendix at page 1. The decision of the district court rendered on November 30, 1993 is reprinted in the Petition for Writ of Certiorari appendix at pages 31 and 37, and the Amended Judgment and decision rendered on December 7, 1993 is reprinted in the Petition for Writ of Certiorari appendix at page 38.

STATEMENT OF JURISDICTION

The Tenth Circuit issued its decision on September 19, 1995. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

The relevant provisions listed below are included in the appendix:

26 U.S.C. § 61(a), Petition for Writ of Certiorari appendix at 49.

Revenue Act of 1918, Section 213(b)(6), Petition for Writ of Certiorari appendix at 49.

26 U.S.C. § 104(a), Petition for Writ of Certiorari appendix at 49.

1989 Amendment to 26 U.S.C. § 104(a), Petition for Writ of Certiorari appendix at 49.

Treasury Regulation § 1.104-1(c), Petition for Writ of Certiorari appendix at 50.

Federal Rule of Civil Procedure 60(a), Petition for Writ of Certiorari appendix at 44.

STATEMENT OF FACTS

In 1983, Betty O'Gilvie died of toxic shock syndrome. In 1988, her estate was awarded, in addition to other damages, $10 million in punitive damages against International Playtex, Inc. After payment of attorney's fees and expenses, the balance of the award was paid to Betty O'Gilvie's heirs at law: her husband, Kelly O'Gilvie, and her children, Stephanie O'Gilvie and Kevin O'Gilvie. Kelly O'Gilvie, the Petitioner, and the children paid the taxes on the punitive damages. Kelly O'Gilvie and the conservator, on behalf of the children, made proper administrative application for refund of those taxes based upon the 26 U.S.C. § 104(a)(2) (hereinafter § 104(a)(2)) exclusion. Petitioner's request for refund was denied. The refund of the children's taxes was recommended by the Commissioner of the Internal Revenue to the Joint Committee of the United States Congress on Taxation, approved and paid in July 1990.

In the federal district court of the district of Kansas, Kelly O'Gilvie sought a refund for taxes paid on the punitive damages award. On May 26, 1992, the district court granted summary judgment in favor of the IRS on the issue of the taxability of punitive damages. (Petition for Writ of Certiorari appendix at 25). On that same day, this Court issued its decision in *United States v. Burke*, 504 U.S. 229, 112 S. Ct. 1867, 92-1 USTC ¶ 50,254 (1992). Petitioner filed a motion for reconsideration, which the district court granted. **Judgment** was entered on August 26, 1992 in favor of the taxpayer, finding that § 104(a)(2) exempted from taxation the award of punitive damages that

taxpayer had received on account of physical injuries. (Petition for Writ of Certiorari appendix at 26 and 29).

The decision that taxpayer's punitive damage award was exempt from taxation under § 104(a)(2) was necessary to render justiciable a second issue of whether an "additional amount" of damages was taxable interest or additional punitive damages and, therefore, also exempt from tax. On October 27, 1992, the district court withdrew its order of August 26, 1992 on the issue of taxability of punitive damages stating:

> Accordingly, pursuant to Rule 60(a), Fed. R. Civ. P, the judgment entered on August 26, 1992 is hereby withdrawn, *subject to reinstatement at the conclusion of the case*.

(Emphasis added). (Petition for Writ of Certiorari appendix at 30).

The second issue was briefed and the district court considered whether the "additional amount" was characterized as punitive damages, and also exempt from tax under § 104(a)(2). The district court entered **Judgment** on November 30, 1993 characterizing the "additional amount" as taxable interest and not as additional punitive damages. (Petition for Writ of Certiorari appendix at 37). The district court states in the introductory paragraph of the **Memorandum and Order** of November 30, 1993:

> In a previous opinion, this court held O'Gilvie's punitive damages award was excludable from income tax pursuant to § 104(a)(2) of the Internal Revenue Code.

(Petition for Writ of Certiorari appendix at 31).

On December 7, 1993, the district court entered on its own initiative under Federal Rule of Civil Procedure 60(a), what the court entitled ***Amended* Judgment** which included the omitted portion of the November 30, 1993 **Judgment**. (Petition for Writ of Certiorari appendix at 39). *No motion to amend or correct the judgment was made by either party at any time*. Taxpayer filed timely notice of appeal on January 5, 1994 on the issue of the characterization of the "additional amount." Defendant filed its notice of appeal on February 1, 1994, more than sixty (60) days from the entry of judgment on November 30, 1993.

SUMMARY OF THE ARGUMENT

The Tenth Circuit, upon finding § 104(a)(2) ambiguous, has improperly expressed and applied an improper "default rule" in favor of the government. The Tenth Circuit found that analysis of extrinsic evidence to interpret the statute, § 104(a)(2), was not necessary. While the "clear intent" to exclude must be found in a taxing statute, that "clear intent" may be found from interpretation of extrinsic facts. Clear and unambiguous language is not a mandatory prerequisite for a finding of "clear intent" to exclude. The "principle of narrow construction" is not a "default rule" that relieves the court from comprehensive review of extrinsic evidence. The premature application of a "default rule" impermissibly limits the full expression and enforcement of Congressional intent.

The proper method of statutory construction for § 104(a)(2) must begin with a review of the words themselves. If these words are ambiguous, the Court must, in order to give full voice and authority to the intent of Congress, review the relevant extrinsic evidence to interpret those words. At least six appellate courts, including the Tenth Circuit in *O'Gilvie* and this Court in *Burke*, have found the words ambiguous. The Sixth Circuit in *Horton*, the Federal Claims Court in *Reese*, and this Court in *Schleier*

have recently found the language plain. However, those three courts have interpreted the statute antagonistically. Reasonable persons have found the statute susceptible to two interpretations.

Understanding the nature of the ambiguity is critical to understanding the confusion which plagues this statute and which must be resolved to decide this case. Ambiguity, by its nature, means two competing or conflicting interpretations of the same language. Resolution of ambiguity requires a choice between the two conflicting interpretations. This statute is a unique case of a patent structural ambiguity. That is, the entire phrase has two distinct meanings, one expressed in the Treasury Regulation, *Threlkeld*, 848 F.2d 81 (6th Cir. 1988), and affirmed in *Burke*; and the other expressed in *Miller*, 914 F.2d 586 (4th Cir. 1990), and progeny.

As an example of structural ambiguity, consider the sentence, "*He told his father he was getting fat.*" In one "clear" interpretation, the *father* was getting fat. In the other interpretation, just as "clear," the *son* was getting fat. The sentence can be read either way with a "clear" meaning, but not both ways at the same time. In a phrase which has a patent structural ambiguity, the interpretations are mutually exclusive. Likewise in § 104(a)(2), the competing interpretations are mutually exclusive. The only method of interpreting which meaning was "intended" is to resort to extrinsic evidence.

For well established reasons, the authority and weight of various extrinsic facts is hierarchical. Of first significance, when the statute is ambiguous, is the language of the prior statute. *Hamilton v. Rathbone*, 175 U.S. 414. Here, the language of the original statute was plain and clearly limited the *type of tort claim* only. Of next significance is the extant Treasury Regulation § 1.104-1(c), published in 1956, which expresses the interpretation that limits the *type of tort claim*. The consistent

administrative practice of excluding punitive damages in cases involving personal injury adds authority to the interpretation of the statute as limiting the *type of claim* and not the *type of damages* that flow from the claim. However, it is the reenactments and amendments made by Congress that carry the greatest weight when those reenactments and amendments required the scrutiny of Congress, as here, and Congress did not change the language to vary the exclusion for punitive damages.

This history from 1918 until 1984, during which time the federal courts scrutinized the language of § 104(a)(2) in at least thirty (30) separate decisions to find that the words "on account of personal injury" modified only the *type of tort claim* and not the *type of damages*, should have led the IRS to the irresistible conclusion that the correct interpretation of the ambiguous statute was the one expressed in the Treasury Regulation, consistently followed by the IRS and approved by Congress.

However, the IRS chose to disregard the very heavy weight of these extrinsic facts to promote an ambiguity in the statute. The ambiguity was created when the original statute was separated in the 1954 Internal Revenue Code. Rev. Rule 84-108 is significant as the litigation position of the IRS because it spotlights the ambiguity. In contrast to the very heavy weight accorded the wording of the original statute to resolve an ambiguity, the Treasury Regulation, published in 1956, the extensive caselaw which construes these words of § 104(a)(2) as meaning a limit on the *type of tort claims* only, and the long standing administrative practice of the IRS (*see* Rev. Rule 75-45), the weight accorded the new Rev. Rule 84-108 is slight.

The courts which have followed the IRS' position have done so out of an unwarranted deference to the IRS' litigation position, and in their efforts to protect the fisc, have applied a method of statutory construction that fails to give full voice and

authority to the intent of Congress. Proper statutory construction requires a choice between the two conflicting interpretations, and the very heavy weight of the intrinsic evidence compels the choice of the interpretation expressed in Treasury Regulation § 1.104-1(c).

The only authority under which the district court could amend its **Judgment** of November 30, 1993 on its own initiative and without motion by a party was under Federal Rule of Civil Procedure 60(a). Because Fed. R. Civ. P. 60(a) does not toll the time for notice of appeal, the IRS' notice of appeal on February 1, 1994, was more than sixty (60) days from the issuance of the **Judgment**, and the Tenth Circuit did not gain jurisdiction to hear the cross-appeal on the issue of § 104(a)(2).

DISCUSSION

I.

THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT HAS EXPRESSED AND APPLIED A METHODOLOGY OF STATUTORY CONSTRUCTION WHICH PLACES AN IMPERMISSIBLE RESTRICTION UPON THE ENFORCEMENT OF CONGRESSIONAL LEGISLATIVE INTENT. UPON A FINDING OF INTRINSIC AMBIGUITY IN THE WORDS OF THE STATUTE, THIS METHODOLOGY REQUIRES THE COURT TO IMMEDIATELY APPLY A "DEFAULT RULE" IN FAVOR OF THE GOVERNMENT.

The duty of all federal courts is to discern the meaning intended by the enacting Congress in the words they wrote. When that intent is evident in the words of the statute, the meaning is plain. If those words are found to be ambiguous, the meaning must be interpreted by resorting to extrinsic facts. The courts have an obligation, consecrated by our constitution and common law, to give full voice to the Congressional acts if those acts are constitutional and within the power and authority of Congress. There has been no suggestion that exemption of punitive damages from taxation is outside the constitutional power and authority of Congress.

Rigorous inquiry into the "intent of Congress" assures the full expression of the purposes of our government's legislative branch and full enforcement of that expression. Premature application of a "default rule" in favor of the government is a suppression of that Congressional intent. The Tenth Circuit found that the statute, § 104(a)(2), is susceptible to two meanings and therefore must succumb to the "default rule." In applying a default rule prematurely, the Tenth Circuit neglected a primary

duty of the court, namely to interpret the intent from extrinsic evidence, if necessary, to give full expression to the acts of Congress. There is ample extrinsic evidence for interpretation of this statute. The Tenth Circuit did not find that interpreting the meaning of the statute was not possible, only that it was not necessary. The reality in *O'Gilvie* is that the intent of Congress is a tattered flag that the Tenth Circuit and those courts it follows do not feel obliged to salute.

This diminishment of the proper role of extrinsic evidence in the construction of Congressional intent was first practiced in interpretation of § 104(a)(2) by the Fourth Circuit in *Commissioner v. Miller*, 914 F.2d 586 (4th Cir. 1990). The Fourth Circuit begins its analysis of § 104(a)(2) thus:

> At the outset, we reject the conclusion of the Tax Court that the plain meaning of § 104(a)(2) compels exclusion of punitive damages from gross income. . . . Instead, *we find that § 104(a)(2) is ambiguous* as to which form of causation is intended by "on account of."

(Emphasis added). *Miller*, 914 F.2d at 590.

In the next step of analysis, the Fourth Circuit's misunderstanding of the proper method of statutory construction is revealed:

> Given the *inherent ambiguity* of § 104(a)(2), we must resort to extrinsic aid to interpretation. . . . First, as the Tax Court recognized, it is a well-recognized, even venerable, principle that exclusions to income are to be construed narrowly. . . .

> **Given that § 104(a)(2)'s language is not plain, the principle is applicable and inclines us to adopt the Government's more restrictive view of what kinds of damages are excludable from gross income under the section.**

(Emphasis added). *Miller*, 914 F.2d at 590.

The flaw is precisely this: The "principle of narrow construction" is not a "default rule" that relieves the court from comprehensive review of extrinsic evidence. The "principle of narrow construction" requires that the intent be discerned from the careful analysis of all extrinsic evidence and that a clear intent to *exclude* is evidenced. The Fourth Circuit did not apply two tests, but expressly adopted the more restrictive of the two tests.

The Fourth Circuit continued its incomplete and flawed analysis by application of only one actual extrinsic aid to interpretation, and that one even forbidden by statute. The Fourth Circuit found an underlying "compensatory purpose" mandated in the descriptive title and arrangement of § 104(a)(2), notwithstanding the fact that such interpretation is expressly prohibited by the Internal Revenue Code at § 7806(b). (Petition for Writ of Certiorari appendix at 40).

In its determination that § 104(a)(2) has an underlying "compensatory purpose," the Fourth Circuit failed to address the careful and considered determinations of the Tax Court and the Sixth Circuit in *Threlkeld* and its progeny that awards are *not required* to be a return of capital or compensatory to be excluded under § 104(a)(2). *Threlkeld v. C.I.R.*, 848 F.2d 81 (6th Cir. 1988); *Burke v. United States*, 504 U.S. 229, 112 S. Ct. 1867 (1992), 92-1 USTC ¶ 50,254; *C.I.R. v. Schleier*, 515 U.S. __, 115 S. Ct. 2159, 95-1 USTC ¶ 50,309 (1995). *See* n. 2, *infra*.

The clearly established Congressional policy to provide tax relief for amounts received because of injury and the death of another is entirely ignored by the Fourth Circuit. The exclusion for amounts received under accident and health plans and the amount of any damages "received on account of personal injuries" was enacted with a humanitarian purpose, "to relieve burdens of sick and disabled through tax relief." § 104(a)(2), (3) (1982) (originally enacted as Revenue Act of 1918, § 213(b)(6), *supra*) *Kuhn v. United States*, 258 F.2d 840, 842 (3rd Cir. 1958); *see also, Epmeier v. United States*, 199 F.2d 508, 511 (7th Cir. 1952); *Huddell v. Levin*, 395 F. Supp. 64, 87 (D.N.J. 1975); *Downey*, 97 T.C. 150 at 4396.

In Part III of Subchapter B of Internal Revenue Code, five of the thirty-six exclusions from gross income are expressions of this Congressional policy of exclusion when money is received by reason of injury, sickness or death. Amounts received under a contract of life insurance, a windfall, are paid by reason of the death of the insured and are excluded under § 101(a). Death benefits (up to $5,000) received from employers, also either a windfall or compensation, are excluded from gross income under § 101(b). Property acquired by bequest, devise or inheritance, that is, by the reason of the death of the donor, is likewise excluded under § 102. Bequests, devises and inheritances are undoubtedly windfalls. Amounts received under health and accident plans are excluded under § 105. Amounts received as periodic payments as damages on account of personal injury are excluded under § 130. And here, under § 104(a)(2) the amount of any damages received in a suit for personal injury is excluded. The Congressional policy of excluding income from tax for those who are afflicted and bereaved is manifested throughout this Part III. The IRS' assertion that the only relevant tax policy is full taxation of compensation denies the existence of Congress' expression of this powerful social policy to benefit those visited by tragedy.

In construing the ambiguous language, the Fourth Circuit did not examine the prior statutory language to clarify this "ambiguous" statute. *See Hamilton v. Rathbone*, 175 U.S. 414. And, despite the abundance of extrinsic evidence which surrounds this statute, the Fourth Circuit did not consider any extrinsic evidence other than the title of the section. In short, meaning of the statute was not properly construed by the Fourth Circuit in *Miller*. *See Crane v. Commissioner*, 331 U.S. 1 (1947). The statute was improperly interpreted by application of a "default rule," and yet the incomplete and incorrect analysis dominates the decisions in the Circuits.

This domination of the Fourth Circuit's analysis in *Miller* has come as the result of the misunderstanding and confusion between the "principle of narrow construction of exclusions from income" and a "default rule." The "default rule" was actually used by the Fourth Circuit and imitated in the cases which follow it, including the Tenth Circuit in *O'Gilvie*. The "principle of narrow construction" is *not* a "default rule" that relieves the court from comprehensive review and analysis of extrinsic evidence. The "principle of narrow construction" requires that the intent be discerned from the careful analysis of all extrinsic evidence and that a *clear intent to exclude* be evidenced.

An ambiguous statute *does not* trigger a "default rule" in favor of the government. The words "any damages . . . received on account of personal injuries," can express the requisite intent, whether by plain meaning *or* from interpretation of extrinsic evidence. The inevitable consequence of such a premature application of a "default rule" is the denial of the full expression and enforcement of the intent of Congress.

Even after the Fourth Circuit's incorrect decision in *Miller*, numerous other courts continued to follow the proper

methodology. Upon finding that the statute was *unambiguous*, some courts applied the *plain meaning* of the original statute to exclude the income from taxation. *Pistillo*, 912 F.2d 145 (6th Cir. 1990); *Burke*, 929 F.2d 1119 (6th Cir. 1991); *O'Gilvie*, 92-2 USTC ¶ 50,567 (D. Kan. 1992); *Hawkins*, 93-1 USTC ¶ 50,208 (D. Ariz. 1993), *Horton*, 100 T.C. 93 (1993); *Horton*, 33 F.3d 625 (6th Cir. 1994); *McKay*, 102 T.C. 465 (1994); and *Bennett*, 30 Fed. Cl. 396 (1994). *See also Hawkins*, 30 F.3d at 1085, dissent of Judge Trott. Before 1990, *see also Miller*, 93 T.C. 330 (1989). These courts which found the meaning *plain*, also found that the statute *excluded* the damages from taxation.

Other courts, upon finding that the words of the statute were *ambiguous*, applied a more complete analysis to interpret the ample extrinsic facts attendant upon this statute. *Threlkeld*, 87 T.C. 1294 (1986); *Threlkeld*, 848 F.2d 81 (6th Cir. 1988); *Metzger*, 88 T.C. 834 (1988); *Downey*, 97 T.C. 150 (1991); *Burke*, 504 U.S. 229; *O'Gilvie* 92-2 USTC ¶ 50,567 (D. Kan. 1992).

After this Court's decision in 1992 in *Burke*, the IRS began to argue for the first time that the phrase — "any damages received (whether by suit or agreement) on account of personal injuries" — has two distinct meanings and creates two distinct tests for excludability under § 104(a)(2). In 1993, the district court in *Rice v. United States*, 834 F. Supp. 1241 (E.D. Cal. 1993), *aff'd without opinion*, 35 F.3d 571 (9th Cir. 1994), made no attempt to interpret or construe the statute, but applied two tests forthwith, one approved in *Burke*, the "nature of underlying claim" test, and the other the Fourth Circuit's "compensatory purpose" test. This decision of the district court in *Rice* was the first time a court had derived two separate tests for § 104(a)(2) from the same language.

The Fourth Circuit in *Miller* had not adopted two tests. The Fourth Circuit in *Miller* chose the more restrictive of two competing interpretations. *Miller*, 914 F.2d at 590, 591.

> Given that § 104(a)(2)'s language is not plain, the principle is applicable and *inclines us to adopt the Government's more restrictive view of what kinds of damages* are excludable from gross income under the section.

Those courts which have followed *Miller* have followed the "default rule" and likewise have chosen the *more restrictive* of the two interpretations. *See also Robinson*, 70 F.3d 34 (5th Cir. 1995).

In *Burke*, this Court stated the first issue to be addressed:

> The Court of Appeals **concluded** that exclusion under § 104(a)(2) *turns on whether the injury and the claim are "personal and tort-like in nature." Id. at 1123. "If the answer is affirmative," the court held, "then that is the beginning and the end of the inquiry* (internal quotation omitted), *Id.* at 1123.

(Emphasis added). *Burke*, 504 U.S. 229, 112 S. Ct. 1867, 92-1 USTC ¶ 50,254 (1992).

In direct response to this conclusion, this Court stated:

> We thus agree with the Court of Appeal's analysis insofar as it focused, for purposes of § 104(a)(2) on the nature of the claim underlying respondent's damages award. See

> 929 F.2d, at 1121; *Threlkeld v. C.I.R.*, 87 T.C., at 1305. Respondent, for their part agree that this is the appropriate inquiry, as does the dissent. . . . In order to come within the § 104(a)(2) income exclusion, respondents therefore must show that Title VII, the legal basis for their recovery of back pay, redresses a tort-like personal injury in accord with the foregoing principles. We turn next to this inquiry.

The Fourth Circuit and this Court were required to interpret the meaning of the phrase "on account of personal injury" and each court expressly adopted the alternative interpretation.

The application of two tests by the district court in *Rice* without analysis is of little significance in the determination of the meaning of the words. However, the lure of avoiding the problem of analysis by the handy expedient of using both tests was too powerful to resist. The Fifth Circuit in *Wesson v. United States*, 48 F.3d 894 (5th Cir. 1995), 94-1 USTC ¶ 50,139, *reh'g denied*, 1995 U.S. App. Lexis 12,574, and the Ninth Circuit in *Hawkins v. United States*, 30 F.3d 1077 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 2576 (1995), found the statute ambiguous, applied two tests and found that, under the application of both tests, punitive damages were taxable. This Court in *Schleier*, 95-1 USTC ¶ 50,309 at 88,117, avoids finding that an *unambiguous* statute has two distinct interpretations by denying that the Treasury Regulation is one interpretation of the statutory language:

> The regulatory requirement that the amount be received in a tort type action is not a substitute for the statutory requirement that the amount be received "on account of

personal injuries or sickness;" it is an additional requirement.

All the courts, except the Federal Court of Claims in *Reese* and this Court in *Schleier*, which have found the language of the statute *plain* since Revenue Rule 84-108 raised the question of "ambiguity," have found that the *plain language* mandates the test expressed in the Treasury Regulation. Only the majority decision of this Court in *Schleier* and the Federal Court of Claims in *Reese* have found the language *plain* and yet applied the *Miller* "compensatory purpose" test.

How could this inconsistent record have been created? Perhaps a results-oriented interpretation of a statute caused the courts to turn Nelson's blind eye to the competing interpretation. Punitive damage awards themselves have been the subject of recent unfavorable controversy and litigation. Or perhaps the very human tendency to reject ambiguity in language and to cling to the impression that is strongest in the reader's mind is the dynamic that has caused some courts to clutch at one view, and deny the other. Unwarranted deference to the utterances of the IRS has played a part no doubt. *Burford*, 642 F. Supp. at 636. Or perhaps the problem lay with the inability of the courts to see the nature of the ambiguity. The articulation of the exact problem has not been a part of any decision up to this time. Whatever combination of reasons, the alternating, and sometimes simultaneous, application of two distinct, competing meanings from the same language has created an untenable record.

The fundamental feature of ambiguity is two or more competing interpretations of the same word or phrase. The test for ambiguity is whether reasonable persons could differ in their interpretation. *Marathon Le Tourneau Company v. National Labor Relations Board*, 414 F. Supp. 1076, 1080. Since 1984, numerous courts have expressly found § 104(a)(2) susceptible to

two distinct interpretations. And in the courts which have found the statute plain, that "plain" meaning has been interpreted disparately.

The Petitioner maintains that the statute was not ambiguous in its original enactment by Congress. The separation of the statute in 1954 into two parts created a situation that required the clarification of the meaning by Treasury Regulation § 1.104-1(c). The "clear intent" to exclude was evident in the original statute and in the 1954 version when read with the Treasury Regulation. The appearance that there was not a *clear intent to exclude* was created by the IRS when it published Rev. Rule 84-108 as its litigation position. The Commissioner's statement in Rev. Rul 84-108 was incorrect because he misread (intentionally) the current statute § 104(a)(2) without the Treasury Regulation which supplied the meaning from the first clause of the original statute when the statute was separated in 1954.

If this statute is ambiguous, then the nature of ambiguity becomes important. The ambiguity found here is not latent ambiguity, where the defect is in some extrinsic fact as to what a word means. For example, the word *bill* is latently ambiguous because it may mean the beak of a duck, the check for dinner, a name, to charge for a service, or a proposed law. Instead the ambiguity that troubles the reader of this statute is a patent ambiguity, one that is intrinsic to the statute itself. More specifically, the ambiguity here is one of a unique species, a patent structural ambiguity. Whether a particular word means more than one thing is of no concern. Whether the entire phrase has two meanings, and therefore creates two tests, is the crux of the matter.

Conceptually, by simply labeling § 104(a)(2) *ambiguous*,

the case is proved. Ambiguity demands a choice between two. However, a more thorough understanding is useful. Two examples will illustrate the nature and limitations of patent structural ambiguity. Consider the following sentence:

Flying planes can be dangerous.

The first meaning that a reasonable person could draw from these words is that being a *pilot* can be dangerous. The second, that an *observer* is in danger from planes flying overhead. Neither interpretation is confusing, but the sentence is structurally ambiguous. Extrinsic evidence must provide the key to interpretation. The one certainty is that the sentence cannot have both meanings at the same time. The observer is not flying the plane, neither is the pilot on the ground with a plane overhead. The interpretations are mutually exclusive.

Consider an even clearer example:

He told his father he was getting fat.

In one "clear" interpretation, these words convey the meaning that the *father* was getting fat. In the other interpretation, just as "clear," that the *son* was getting fat. The sentence can be read either way, but not both ways at the same time. The only method of interpreting which meaning was "intended" is to look to extrinsic evidence.

Consider now the original statute, § 213(b)(6):

> Amounts received through accident or health insurance or under workman's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness.

In the first interpretation, the phrase "on account of such injuries," modifies the *type of suit*. This first test has been articulated as excluding "those damages which are received through prosecution of a legal suit or action based upon tort or tort-type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c); *Burke*, 504 U.S. 229, 112 S. Ct. 1867, 92-1 USTC ¶ 50,254 (1992); *Threlkeld*, 848 F.2d 81 (6th Cir. 1988); *Threlkeld*, 87 T.C. 1294 (1986).

In the second interpretation, the phrase "on account of such injuries" modifies the *type of damages*. The second test has been articulated as meaning that the damages must be compensatory of the personal injury. *Commissioner v. Miller*, 914 F.2d 586 (4th Cir. 1990), 90-2 USTC ¶ 85,713 (1990); *O'Gilvie v. United States*, 66 F.3d 1550 (10th Cir. 1995), 95-2 USTC ¶ 50,508. Both interpretations are clear, neither is confusing. The phrase is "ambiguous" because the entire clause has two distinct meanings. However, only one test can be derived from this language. The key to which meaning was intended must come from extrinsic evidence.

Even though the statute is structurally ambiguous, the words of the statute must be interpreted in a manner that is reasonable, consistent, and most importantly, with only one interpretation. This Court must, as it did in *Crane*, *supra*, interpret from extrinsic evidence to determine which of the two mutually exclusive and competing interpretations was intended by the enacting Congress and the later Congresses that separated the clauses, and knowingly approved and amended the statute.

II.

BOTH THIS COURT IN *SCHLEIER* AND THE SIXTH CIRCUIT IN *HORTON* FOUND THE STATUTE *UNAMBIGUOUS*, YET ARRIVED AT OPPOSITE CONCLUSIONS ABOUT THE MEANING AND RESULTS. THIS COURT IN *BURKE* AND THE TENTH CIRCUIT IN *O'GILVIE* FOUND THE STATUTE *AMBIGUOUS* AND YET ARTICULATED DIFFERENT AND MUTUALLY EXCLUSIVE TESTS. THE CONFLICT BETWEEN THE CIRCUIT COURTS IS NOT RESOLVED BY APPLICATION OF THE PRINCIPALS OF STATUTORY INTERPRETATION DESCRIBED BY THIS COURT IN *SCHLEIER*.

The cases of *Horton* in the Sixth Circuit and *O'Gilvie* in the Tenth Circuit share two essential characteristics. In both, the nature of the underlying claim is undeniably a tort and there is physical injury: in *O'Gilvie* a death, and in *Horton*, damage to a residence. No other circuit has dealt with a case involving both characteristics.

The legal analysis of whether an award made under the federal anti-discrimination statute is excluded under § 104(a)(2) as in *Burke* and *Schleier*, in the narrow sense, is not applicable to the determination of whether awards are excludable when it is uncontested that there is an underlying physical injury claim as in *O'Gilvie*. The *Burke* and *Schleier* decisions do not address punitive damages awarded in a case which involves physical injury, but only whether ADEA damages are excluded. However, the circuit courts in *Horton* and *O'Gilvie* rely largely upon the analysis provided by these two cases. Because the IRS did not seek review of the decision of the Sixth Circuit in favor of the taxpayer in *Horton*, this is the first opportunity to clarify the exclusion in a case in which the underlying tort is for physical injury.

Despite the similarities in the two cases, these two sister courts were unable to agree on the meaning or even a *method of construction* of the meaning of the words in § 104(a)(2). Even after *Schleier*, the Tenth Circuit does not, because it cannot logically, follow the methodology of the *Schleier* decision.

The source of the confusion in the courts since 1984 regarding the status of the law is demonstrated in the application of that case law by the Tenth Circuit. The Tenth Circuit overruled the district court decision finding that § 104(a)(2) is susceptible to at least two different meanings, and is, therefore, *ambiguous*.

> Neither the *Burke* nor the *Schleier* Court addressed the question whether the phrase in § 104(a)(2) "on account of" personal injuries is ambiguous. With respect to this [question of ambiguity] *we agree with the four circuits that have found it is susceptible of at least two meanings.*

(Emphasis added). *O'Gilvie*, 95-2 USTC ¶ 50,508 at 89,639.

Upon the finding of *ambiguity*, the Tenth Circuit then employs the appealing but defective method of immediate reliance upon a "default rule" to the exclusion of all other methods of statutory construction:

> In sum, it is not clear whether Congress intended to excluded punitive damages from income under § 104(a)(2). *Although "good reasons tug each way" in this case, we need not decide "which tug harder," because we must follow the default rule that exclusions from income are narrowly construed.*

(Emphasis added). *O'Gilvie*, 95-2 USTC ¶ 50,508 at 89,641. **The Tenth Circuit specifically holds that the only requirement in the face of ambiguity is to construe the provision strictly in favor of the government.** The Tenth Circuit did not follow the methodology of *Schleier* to find the meaning *plain* even though the Tenth Circuit states that it follows *Schleier*. Use of a "default rule" when the statute is ambiguous is appealing in its simplicity and directness, and, in view of the unique type of ambiguity in the statute, understandable. This methodology, however, has produced seemingly irreconcilable results. It is this flaw in method which is the source of great confusion.

The Fourth Circuit in *Miller*, the Federal Circuit in *Reese*, the Fifth Circuit in *Wesson*, the Ninth Circuit in *Hawkins*, the Tenth Circuit in *O'Gilvie*, and this Court in *Schleier* have found the "default rule" controlling. The statute was found to be *ambiguous* in *Miller*, *Reese*, *Hawkins*, *Wesson* and *O'Gilvie*. However, the statute was found to be plain in *Schleier*. If the statute is *plain and unambiguous*, there is no need to resort to a "default rule." If the statute is *ambiguous*, construction by resort to extrinsic evidence is required and a "default rule" has no function.

The fact that this Court found the statute *ambiguous* in *Burke*, but found the same language *plain* in *Schleier* illustrates the confusion. Notwithstanding the statement by the Tenth Circuit in *O'Gilvie* that "[n]either the *Burke* nor the *Schleier* court address the question of ambiguity," this Court in *Schleier* is adamant that the meaning of the statute is plain and unambiguous. In at least four different instances in the *Schleier* decision, this Court makes that declaration: "In our view, **the plain language of the statute** undermines the respondent's contention," *Schleier*, 95-1 USTC ¶ 50,309 at 2,163. "In contrast, no part of respondent's ADEA settlement is excludable under the **plain language of § 104(a)(2),**" *Id.* at 2,164. "Respondent seeks to circumvent the **plain language of**

§ 104(a)(2) by relying on the Commissioner's regulation interpreting that section," *Id.* at 2,165. "In sum, the **plain language of § 104(a)(2)**, the text of the applicable regulation and our decision in *Burke* establish two independent requirements that a taxpayer must meet before a recovery may be excluded under § 104(a)(2)," *Id.* at 2,167.

The majority opinion in *Schleier* makes no effort to interpret from extrinsic evidence but relies upon the *plain language* and the "default rule" for the meaning.

> We have also emphasized the corollary to § 61(a)'s broad construction, namely, the 'default rule' of statutory construction that exclusions from income must be narrowly construed.

Id. at 2,163.

This threshold determination in *Schleier* of an *unambiguous* statute is contrary to the holdings in the appellate decisions upon which the Tenth Circuit relies: *Miller*, *Hawkins*, *Wesson*, and *Reese*. Only the Court of Claims in *Reese v. United States*, 24 F.3d 228 (Fed. Cir. 1994), 94-1 USTC ¶ 50,232 (Fed. Claims 1994), found the statute *unambiguous* and determined, as this Court did in *Schleier*, that the plain and unambiguous meaning prohibited the exclusion to punitive damages. The Circuit Court of Appeals for the Federal Circuit *affirmed* the holding that the damage award was not excluded. However, the Federal Circuit *firmly reversed* the Court of Claims in regard to the finding of ambiguity. "The language 'on account of' is not free of ambiguity; rather, it is susceptible of at least two conflicting interpretations," *Reese*, 24 F.3d at 230. The Federal Circuit then applied the "default rule."

There are other courts which have found, as this Court did in *Schleier*, that this statute is *unambiguous*. Each of these courts, however, applied the "plain meaning" to hold that the punitive damage, or liquidated damage award is excluded by § 104(a)(2). *Burford*, 642 F. Supp. 635 (N.D. Ala. 1986); *Horton*, 100 T.C. 93 (1993); *Horton*, 33 F.3d 625 (6th Cir. 1994); *O'Gilvie*, 92-2 USTC ¶ 50,567 (D. Kan. 1992); *Hawkins*, 93-1 USTC ¶ 50,208 (D. Ariz. 1993); and *Miller*, 93 T.C. 330 (1989).

While both the Sixth Circuit in *Horton*, 33 F.3d 625, and the Tax Court in *Horton*, 100 T.C. 93, agree with this Court in *Schleier* that the meaning is *plain*, the decisions of those courts are at odds. The Tax Court and the Sixth Circuit applied the *plain meaning* of the statute to exclude from taxation all damages that flow from a tort claim for personal injury, including punitive damages. This Court in *Schleier* applied the *plain meaning* to tax punitive damages.

This Court in *Burke* found the meaning of the statute *ambiguous*, applied proper methods of statutory construction and determined that the interpretation expressed in the Treasury Regulation § 1.104-1(c) was intended. *See Burke*, *id.* at 1,870, and *Schleier*, 115 S. Ct. at 2,172 (O'Conner, J. dissenting). Although the facts and the question were virtually identical in *Burke* and *Schleier*, this Court did not mention application of two interpretations or tests from the same words in *Burke*. Instead, this Court gave approval to the *interpretation* expressed in the Treasury Regulation. *Burke*, 115 S. Ct. at 2,166. In *Schleier*, the Treasury Regulation has lost its status as a valid interpretation and has been relegated to the position of a requirement "in addition to" the statutory requirement. No consistent methodology can be derived from this caselaw and no logical results can be achieved.

III.

THE TENTH CIRCUIT HAS ENTERED A DECISION THAT IS IN CLEAR CONFLICT WITH THE ENACTING CONGRESS' ORIGINAL INTENT OF THE MEANING OF THE WORDS OF THE REVENUE ACT OF 1918 SECTION 213(b), THE DIRECT PREDECESSOR OF I.R.C. § 104(a)(2).

The Tenth Circuit *states* that the Sixty-Fifth Congress wrote the words of § 213(b) of the Revenue Act of 1918 to exclude "any damages" because Congress believed those amounts were not within the definition of gross income. The Tenth Circuit quotes the legislative history which specifically indicates that the bill which was enacted as § 213(b) provided that such amounts *shall* be excluded from gross income:

> Under present law it is doubtful whether amounts received throughout accident or health insurance, or under workman's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income. *The proposed bill provides that such amounts shall not be included in gross income.*

H.R. Rep. No. 767, 65th Cong. 2d Sess. 9-10 (1918) (*Quoted in Reese*, 24 F.3d at 233) (Emphasis added).

O'Gilvie, 95-2 USTC ¶ 50,508 at 89,639. This doubt whether such amounts were required to be included in gross income extended to punitive damages as well. *Commissioner v. Glenshaw Glass*, 348 U.S. 426, 75 S. Ct. 473, 211 F.2d 928

(1955), *reh'g denied*, 349 U.S. 925 (1955); *Downey*, 97 T.C. 150 at 4396. The Congressional enactors were well aware that punitive damages existed as part of the broad range of damages awarded in tort claims. *Burke*, 112 S. Ct. at 1871. The definition of income was not an obscure issue in 1918 when this statute was originally enacted. In 1894, the income tax act had been declared unconstitutional based on the definition of income. In the 1913 federal income tax law, the definition for net income included the phrase "and any income derived from any source whatever." Federal Income Tax Law of 1913, Section B, lines 1-19. The Sixteenth Amendment to the Constitution which was ratified in 1913 empowered Congress "to tax and collect taxes on incomes from whatever source derived." Whether these amounts excluded under § 104(a)(2) were income was an issue that would be the subject of litigation over the next eight decades. Shortly after the enactment of § 213(b) this Court's decision in *Eisner v. Macomber*, 252 U.S. 189, seemed to indicate that such amounts were not income. That assumption was eroded in subsequent years with *United States v. Kirby Lumber*, 284 U.S. 1 (1931); *Helvering v. Bruun*, 309 U.S. 461 (1940); and *Glenshaw Glass*, *supra*. Whether the individual members of the Sixty-Fifth Congress believed the amounts to be income is not certain and can never be known. If that Congress believed the amounts were income, or if they were unsure, then they resolved the issue with the words they wrote.

Even if Congress believed those amounts were not income, they enacted that belief into law. The Sixty-Fifth Congress drafted the original statute to *deny* the exclusion to damages for contract claims and for property tort claims. The exclusion, by its express terms, was intended only for damages received for personal tort claims. Section 213(b) of the Act provided that gross income does not include:

> (6) *Amounts received*, through accident or health insurance or under workman's compensation acts, *as compensation for personal injuries or sickness, plus* the amount of *any damages received whether by suit or agreement on account of such injuries or sickness.*

(Emphasis added).

Note the drafting dilemma the enactors confronted: The second sentence could have been written "plus any damages received in a suit *for such injuries or sickness.*" Then "for such injuries" would unambiguously modify "suit." But when adding the idea of permitting the exclusion for agreements made "on account of such injuries," the drafters could not write "plus the amount of any damages received whether by suit or agreement for such injuries." The grammar didn't work; it was not the intent to exclude damages where the party agreed to the injury in advance. *See Erlich v. Higgins*, 52 F. Supp. 805 (S.D.N.Y. 1943); and *Starrels v. C.I.R.*, 304 F.2d 574 (1962). The words "on account of" were the accommodation the drafters had to make in order to grant the exclusion to awards made by agreements as well as by suits.

That enacting Congress did not express a limit to the *type of damages* that were excluded in the statute, only to the *type of claim* from which the damages arose. The use of the word "any" before damages does not limit damages. An example is illustrative. The first section of the first article of the United States Code gives the following guidance: "In interpreting the meaning of any Act of Congress, unless the context indicates otherwise, word importing the singular apply to several persons, parties, or things." 1 U.S.C. § 1. "Any" is a singular adjective. *Webster's Ninth New Collegiate Dictionary* (1987). "All" is a plural adjective. *Id.* Just as "any" Act of Congress means "all"

Acts of Congress in 1 U.S.C. § 1, "any" damages received means "all" damages received in § 104(a)(2). Applying 1 U.S.C. § 1 to the words in § 104(a)(2) "any damages received" means "*all* damages received" when such damages are awarded in an action for personal (physical) injury or received by agreement on account of that personal injury.

If the enacting Congress believed the amounts excluded were *not* income, as the Tenth Circuit in *O'Gilvie*, the Fourth Circuit in *Miller*, and the Tax Court in *Downey* have stated, then the courts have vitiated the original intent of the enacting Congress by the finding that the enacting Congress was under a "mistaken belief" about the law. These courts which adopted the *revised* intent theory found that the words "any damages . . . received on account of personal injury" do not now mean what the Congressmen who wrote them thought they meant. This reinterpretation of "original intent" is untenable. A "mistake" of law or a change in the understanding of the law that occurred more than 66 years after the enactment did not alter or revise that original intent.

The proper inquiry is: "*What did the original enactors intend* ***those words*** *to mean when they wrote them?*" *Those words* at that time were *intended* by the Sixty-Fifth Congress to exclude ***all*** damages. Perhaps, Congress wrote those words *because* they did not believe those awards were includable in gross income. But there can be no doubt that, at that time, those words were written ***to exclude*** *any* damages awarded in personal injury cases.

Congressmen of that Sixty-Fifth Congress, if asked in 1919 what was intended by those words, would have answered, "The words exclude any and all damages, including punitive damages." If the Judges and Justices making the decision were taken back to 1920, nearer to the time of enactment, and asked the

question they are being asked today, "What do these words mean?" they would find, as a matter of law, that any and all damages, including punitive damages, are excluded by the words of the statute. This was the IRS' understanding of the original statute. *Burke*, 112 S. Ct. at 1,875.

The distinction between *amounts received as compensation* and *any damages* is clear in both the wording of the original statute and in the 1933 Treasury Regulation which interprets that original enactment. Treas. Reg. 77, Art. 82 (1933). In the first phrase of the original statute and the first sentence of the 1933 Treasury Regulation, the "amounts received . . . as compensation for personal injuries . . ." are in clear contrast to the second phrase of the original statute and the second sentence of the Treasury Regulation "any damages recovered . . . on account of such (personal) injuries." This Treasury Regulation from 1933 articulates the interpretation that "on account of personal injury" defines the *type of tort claim*.

With the enactment of the Internal Revenue Code of 1939, the exclusion, now found at § 22(b)(5), was given the special scrutiny of Congress. A limitation to the exclusion was added in regard to the deduction for medical expenses under § 23(x) (now I.R.C. § 213). § 22(b)(5) of the Internal Revenue Code of 1939 repeated the exclusion found in § 213(b)(6).

The absence of explanation in later Treasury Regulations would indicate that the law was thought clear enough to require no explanation. (Treas. Reg. 86 (1935), Treas. Reg. 94 (1936), Treas. Reg. 111 (1943), and Treas. Reg. 118 (1953) contain no administrative interpretation of § 22(b)(5)). Knickerbocker, *The Income Tax Treatment of Damages: A Study in the Difficulties of the Income Concept*, 47 Cornell L.Q. 429, 436-40 (1962).

In 1954, Congress again enacted a new revenue code in

which the two clauses of § 22(b)(5) were separated by placing the provisions relating to the exclusion of workman's compensation payments, accident and health insurance proceeds in the new § 105 and the provisions for exclusion of damages received on account of "such" injuries in the new § 104(a)(2). The second clause of the original statute had been dependent upon the first clause for its full meaning. Upon this separation, new Treasury Regulations for § 104(a)(2) were issued in 1956 to clarify the meaning of the newly separated "any damages received" phrase. The new Regulation defines "damages" in this context as "an amount received (other than workman's compensation) through prosecution of a legal suit or action based upon tort or tort-type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c) (1956). This Treasury Regulation preserves the meaning once supplied by the first phrase of the original statute. The Treasury regulation is an integral part of the meaning of the original enactment which was made necessary by the separation of the two *phrases* of the statute.

The significance of these later Congresses' reenactments of the section virtually unchanged is that the authority of those later Congresses is added to the authority of the enacting Congress to approve of the exclusion for "any damages received," including punitive damages, in cases where the underlying claim is a personal tort.

The decision of a later court can not reform "original intent," yet the IRS has cited *Glenshaw Glass*, *supra*, as primary support for the proposition that § 104(a)(2), previously § 213(b)(6), does not exclude punitive damages. *Glenshaw Glass* does not mandate taxation of all punitive damages in all events. The genius of *Glenshaw Glass* is that punitive damages are income and, *unless otherwise specifically excluded*, taxable. In the words of the majority in *Glenshaw Glass*, some exclusion of

punitive damages is anticipated. It is *this very exclusion*, in what is now § 104(a)(2), that is anticipated, for there is no other exclusion of punitive damages found in the Internal Revenue Code. *Glenshaw Glass* does not suppress or transform the "original intent" of the enacting Congress. *Glenshaw Glass* acknowledges and confirms the specific exclusion for these punitive damages.

After the *Glenshaw Glass* decision in 1955, the Internal Revenue Service, Congress, and the courts *continued* to approve the original codification which excluded all damages. Exclusion of punitive damages recovered in personal injury claims under § 104(a)(2) was an established administrative practice of the IRS for 66 years from the enactment of § 213(b) in 1918 until 1984. (*See* Rev. Rul. 58-578, 1958-2 C.B. 38; Rev. Rul. 75-45, 1975-1 C.B. 47; Gen. Couns. Mem. 35,967 (August 27, 1974); Priv. Ltr. Rul. 7304120600A (April 12, 1973)).[1] These long-standing established administrative practices describe the meaning of the statute as limiting the *type of tort claim*. These administrative statements came after 1955 when the IRS was well aware of the significance of *Glenshaw Glass*, that punitive damages were income, unless otherwise excluded.

Treasury Regulation § 1.104-1(c) (1956) had been in effect for 28 years before Rev. Rul. 84-108 was published by the Commissioner, and not until after this Court's decision in *Burke* in 1992, had the IRS or any court ever suggest that the statute created two tests. Treasury Regulation § 1.104-1(c) is the expression of one interpretation, long recognized as the correct interpretation.

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1. The General Counsel memorandum and the Private Letter Ruling are not cited nor relied upon as precedent. I.R.C. § 6110(j)(3). Both documents, however, are competent evidence of administrative practice. *Rowan Cos. v. United States*, 452 U.S. 247, 261 n. 17, 68 L. Ed. 2d 814, 826 n.17 (1981).

The government adhered to the "original intent" of the statute and 19 years after *Glenshaw Glass* described the *plain meaning* and the established administrative practice in General Counsel Memorandum 35,967 (August 27, 1974) which expressed the interpretation of this structurally ambiguous statute of limiting the *type of tort claim* only:

> . . . I.R.C. § 104(a)(2) is a specific statutory exclusion from gross income within the "except as otherwise provided" clause of I.R.C. § 61(a). . . . Therefore, under I.R.C. § 104(a)(2), *any damages, whether compensatory or punitive and whether a substitute for income or not*, received on account of personal injury or sickness are excludable from gross income. . . . *There is nothing in the legislative history of I.R.C. § 104, or the regulations thereunder indicating that punitive damages awarded in connection with personal injuries should be includable in gross income.*

(Emphasis added).

Twenty years **after** the decision in *Glenshaw Glass*, the Commissioner of the Internal Revenue continued to adhere to the established interpretation of the statute in Revenue Ruling 75-45:

> Therefore, under § 104(a)(2) any damages, whether **compensatory or punitive**, received on account of personal injuries or sickness are excludable from gross income.

(Emphasis added). Rev. Rul. 75-45, 1975-1 C.B. 47. The

Treasury Regulation § 1.104-1(c), these official statements by the IRS, the General Council's Memorandum, *supra*, and Rev. Rule 75-45, define the meaning of the statute at a time closer to its enactment, and evidence a continued adherence to the understood and established interpretation.

The enactor's original intent cannot be reformed administratively 66 years after the enactment. However, the actions and knowing approval of subsequent Congresses, especially in the wake of the significant change in the understanding of the law brought about by *Glenshaw Glass*, are properly regarded as the intent of those Congresses. *See Crane*, 675 S. Ct. at 1051; *Burke, supra*. Section 104(a)(2) has been re-enacted without material change repeatedly throughout the last 78 years. *Reese*, 24 F.3d 228 (Fed. Cir. 1994), note 2. Re-enactment and amendment to the statute without change is the *most authoritative evidence of Congressional approval* of the long standing administrative interpretation of the statute as excluding punitive damages. *Eli Lilly v. EPA*, 615 F. Supp. 811 (S.D. Ind. 1985); *Massachusetts Mutual, Life Ins. Co. v. United States*, 5 Cl. Ct. 581 (1984), *aff'd*, 761 F.2d 666 (Fed. Cir. 1985); and *Crane v. Commissioner*, 331 U.S. 1 (1947).

From the time of the original enactment of § 213(b)(6) in 1918 until the publication of Revenue Ruling 84-108 in 1984, 66 years passed during which the statutory provision was not altered with the *enactment* of nine subsequent Revenue Acts. Section § 104(a)(2), *with the relevant language unchanged*, was adopted into the 1939 and 1954 Codes. Treasury Regulation § 1.104-1(c), which pertains precisely to this provision, was adopted in 1956, and approved by Congress by those *re-enactments*.

Congress *amended* § 104 three times in the nine years following the publication of Rev. Rul. 75-45. (*See* Pub.L.No. 94-

455, § 505(e), 1901(a)(17) (adding a new subsection to § (a)); Pub. L. No. 96-465, § 2206(e)(1) (giving effect to the Foreign Service Act of 1980); and Pub. L. No. 97-473, § 101(a) (enlarging the scope of subsection (a)(2) by adding to that exclusion what would otherwise be the taxable interest component of "structured settlements").) Although the very subsection at issue was amended after the publication of Rev. Rul. 75-45 and *attention to the interpretation of the exclusion was necessary*, Congress did not change the interpretation of the Treasury Regulation nor the pertinent holding of the Rev. Rul. 75-45 in any one of these amendments. The exclusion of punitive damages was a prior long-standing and consistent administrative practice embodied in the holding of Rev. Rul. 75-45 and in Treasury Regulation § 1.104-1(c).

In 1989, Congress once again considered § 104(a)(2) and *acted* to limit the exclusion of punitive damages to awards in connection with physical injury or physical sickness only. This Court in *Burke* acknowledged and validated that change in 1992. *Burke*, 112 S. Ct. at 1871 note 6, and 1876 note 3 (Scalia, J. concurring).

In 1984, the Commissioner, without impetus from court decision, Congressional act, or other relevant source, reversed his administrative position on the exclusion of punitive damages in Rev. Rule 84-108. Even then, the IRS did not suggest the idea that there were two tests for excludability in § 104(a)(2), only that the more restrictive test applied.

In 1995, without a review of the long history of Congressional action and acquiescence with regard to this statute, the Tenth circuit joined the Ninth Circuit in its opinion that Congress did not know what it was doing when it enacted the Amendment to § 104(a)(2). The Ninth Circuit in *Hawkins* asserted "... the views of a subsequent Congress form a

hazardous basis for inferring the intent of an earlier one." *Hawkins*, 30 F.3d at 1,082. The corollary to that principle is even more apt. *The view of a subsequent Commissioner involved in litigation forms an even more hazardous basis for inferring the intent of Congress.*

In view of the plain language of the original statute, the contemporaneous statements of intention by the enacting Congress, the extant Treasury Regulation, the long standing administrative practice, and the knowing approval and amendments of many Congresses, such a change by the Commissioner is an unwarranted administrative legislation. *See Burford*, 642 F. Supp. 635. The Tenth Circuit has gravely misplaced its allegiance when it gives greater weight to the litigation position of the IRS than to the continuing acts and acquiescences of the governmental body charged with making the laws.

Can the intent change after enactment when the words do not change? If no, then the *original intent* of the enacting Congress, although perhaps based on an incorrect legal fact, is still that *any and all* damages are excluded. If the meaning evolves, then the intention of the subsequent Congresses, including the Congress which enacted the 1989 Amendment, is of greatest relevance to the inquiry and not to be summarily dismissed. *Hawkins*, 30 F.3d, at 1086 (Trott, J. dissenting).

As the Tenth Circuit has aptly noted, the courts have not applied the *revised original intent* to limit the *type of damages* to prohibit exclusion of the awards for lost wages, business losses, or losses as the result of injury to personal and business reputation, notwithstanding the fact that these awards are now known to be "otherwise taxable" as well.

[T]his rational [of an underlying

> compensatory purpose] is somewhat problematic. If . . . a plaintiff recovers for wages lost due to his being injured in an accident, that amount would be excludable from gross income under § 104(a)(2), and thus not taxable. But if he had actually worked, his wages would be reportable income subject to taxes; thus the § 104(a)(2) exclusion has made him more than whole.

O'Gilvie, 95-2 USTC ¶ 50,508 at 89,640.

Under the weight of the caselaw, that meaning "intended" by Congress in 1918 in the words of § 213(b)(6), which expressly exclude any damages if received for a tort claim, cannot properly be reformed to exclude only those awards which are compensatory.

IV.

THE RATIONALE UNDERLYING THE DECISION OF THE TENTH CIRCUIT IS CONTRARY TO AND OVERRULES A LONG LINE OF SETTLED CASE LAW THAT HAS BEEN RELIED UPON BY TAXPAYERS, COUNSEL, TAX ADVISORS, AND THE IRS TO INTERPRET I.R.C. § 104(a)(2). SUCH RATIONALE APPLIES A "COMPENSATORY PURPOSE" TEST REJECTED BY THOSE CASES.

The case law has been sparse regarding the exclusion of punitive damages awarded in actual physical injury cases. Only *Burford*, *Horton*, and *O'Gilvie* have dealt with physical injury. However, the case law with respect to the interpretation of § 104(a)(2) at issue here has been voluminous. (*See Summary of Cases*, Petition for Writ of Certiorari appendix at 46). And, until

Miller, *supra*, the courts had consistently rejected the "compensatory purpose" test and the "return of capital" rationale.

The IRS first argued in 1972 that only awards which were in the nature of a *return of capital* were excludable. Taxpayers were asking that lost wages awarded because of their personal injuries be excluded from income under § 104(a)(2). The IRS argued that the award for lost wages was made to compensate for the economic loss and not as compensation for the personal injury. The courts repeatedly rejected the interpretation that § 104(a)(2) prohibited the exclusion because of the *type of damages* and further rejected the proposition that exclusion under § 104(a)(2) is limited to damages which are compensatory or are a *return of capital*.[2] **In no reported decision has the fact that an award for lost wages or economic losses is not a return of capital prevented exclusion under § 104(a)(2) where the underlying claim was for personal injury.** These courts note that, without a specific exclusion, these items would be taxable, but consistently find that § 104(a)(2) provides the required specific exclusion. Under the weight of these cases, which hold awards of lost profit and wages excludable, although those awards are ***not a return of capital***, the assertion that the statute has an underlying "compensatory" purpose is insupportable. The test that requires that result must be rejected.

The next spate of cases came as the result of the IRS seeking to limit the *type of damages* excluded to only awards for *physical*

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2. *Seay*, 58 T.C. 32 (1972); *Wolfson*, 651 F.2d 1228 (6th Cir. 1981); *Church*, 80 T.C. 1104 (1983); *Roemer*, 716 F.2d 693 (9th Cir. 1983); *Threlkeld*, 848 F.2d 81 (1988); *Metzger*, 88 T.C. 46 (1988); *Bent*, 835 F.2d 67 (3rd Cir. 1987); *Wulf*, 883 F.2d 842 (10th Cir. 1989); *Thompson*, 866 F.2d 709 (4th Cir. 1989); *Byrne*, 883 F.2d 211 (3rd Cir. 1989); *Rickel*, 900 F.2d 655 (3rd Cir. 1990); *Redfield*, 940 F.2d 542 (9th Cir. 1991); *Pistillo*, 912 F.2d 145 (6th Cir. 1990); *Downey*, 97 T.C. 10 (1991); *Burke*, 929 F.2d 1119 (6th Cir. 1991); *Rice*, 834 F. Supp. 1241 (E.D. Cal. 1993); *McKay*, 102 T.C. 16 (1994); *Bennett*, 94-1 USTC ¶ 50,044 (1994).

injury. The IRS asked the courts to read the "on account of personal injury" portion of the phrase to mean "as compensation for *physical* injuries" only. *Roemer*, 716 F.2d 693; and *Threlkeld*, 848 F.2d 81. Thus the IRS argued that the exclusion was not available for economic loss, such as loss to reputation, etc., because the injury was not physical. *Wolfson*, 651 F.2d 1228; *Church*, 80 T.C. 1104; *Roemer, supra*. These attempts to limit the *type of damages* excluded by the words "on account of personal injury" were rejected. These courts rejected the "compensatory purpose" test which limited the *type of damages* excluded, and uniformly held that once the "underlying claim" for personal injury was found, then *all* damages which flowed from that claim are excludable. The statute was consistently interpreted to apply only the "nature of the underlying claim" test as the beginning and the end of the inquiry. *Burke*, *supra*; *Threlkeld*, *supra*; *Horton*, *supra*.

The *type of tort claim is* limited by the language of the statute: A *personal injury* tort must be found to be the underlying claim before the exclusion for any damages is granted. The wording of the original statute carefully denies the exclusion to damages for contract claims and property tort claims. The exclusion, by its express terms, was intended for all damages received only for personal tort claims. It would have been reasonable to interpret "*personal* injuries or sickness" as "*physical* injuries or sickness" and further limit the *type of underlying tort claim* that would be necessary to qualify for the exclusion. However, throughout the long administrative practice from 1918 until 1985, that distinction has not been made. The caselaw definition of personal tort to include torts for non-physical injury was also a reasonable, if generous, interpretation. In its litigation efforts, the IRS has argued that the language "on account of personal injury" required inquiry into the *type of damages*, instead of inquiry into the *type of the underlying claim*. The courts have never before been asked to

address whether the phrase "on account of personal injuries and sickness" which properly limits the *type of claim*, was intended to further limit the *type of claim* to only those claims for *physical* injury and sickness.

Just as the decisions in *Threlkeld* and *Burke* were beginning to narrow the areas of uncertainty, the comments in *Schleier* regarding application of a "compensatory purpose" test have again generated confusion. The application of a "compensatory purpose" test and the rationale of "return of capital" in *Schleier* to limit the *type of damages* excluded indicates that the lower courts decisions in all the preceding cases where the IRS argued for application of the "compensatory purpose" test have been wrongly decided. In each case, those courts determined that there was only one test and that test was the "nature of the underlying claim" test. Petitioner respectfully asks this Court to reject the interpretation that the words "on account of personal injury" limit the *type of damages*, and adopt the interpretation that the words "on account of personal injury" limit the *type of tort claim*.

V.

THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT HAS INTERPRETED A FEDERAL STATUTE, I.R.C. § 104(a)(2), IN SUCH A MANNER THAT THE 1989 AMENDMENT TO THAT STATUTE IS RENDERED MEANINGLESS.

The inescapable conclusion of the Tenth Circuit's decision in *O'Gilvie*, *supra*, is that § 104(a)(2) exempts no punitive damages at any time. Thus the statute, as amended, is declared void on its face as to exclusion of punitive damages. However, it is evident from the text of the amendment that Congress believed that the statute exempts not only *non-physical damages* received

on account of personal injuries, but also exempts *punitive damages* received on account of personal injuries. Even the closest reading reveals that the language of the 1989 amendment is *limiting* only:

> Paragraph (2) shall not apply to any punitive damages in connection with a case *not* involving physical injury or physical sickness.

(Emphasis added). Section § 104(a)(2). There are no words in the amendment which increase, enlarge, or expand the exemption in paragraph (2). The careful, if awkward, wording of the amendment demonstrates the intention of Congress to leave undisturbed the meaning of paragraph (2) in the prior statute.

O'Gilvie supplies the first instance in which punitive damages for physical injury care were found not to be excluded and the amendment to the statute is directly shown to be meaningless. In *Hawkins*, 30 F.3d 1077, the punitive damages award was made for breach of good faith, not for physical injury. In *Reese*, 24 F.3d 228, the punitive damages award was for sexual harassment. The other physical injury cases, *Burford* and *Horton*, are in accord with the express meaning of the 1989 Amendment. *O'Gilvie* is the only physical injury case which prohibits the exclusion to the taxpayers. The amendment to the statute limits the exclusion under § 104(a)(2) to only punitive damages awarded in connection with physical injury. If the Tenth Circuit is followed, those punitive damages were not excluded anyway and the amendment is inoperative and invalid. The Tenth Circuit does not resolve the "troubling" issue of the 1989 Amendment but, in effect, states that Congress didn't know what it was doing.

The taxpayer directs the Court's attention to the 1989

Amendment of § 104(a)(2) to clarify and illuminate the prior law, not for retroactive application of the statute. This use of subsequent enactment of a statute is approved and demonstrated in *Burke*, *supra*; the 1899 case, *Hamilton*, 175 U.S. 414 (1899); and in *United States v. Community TV, Inc.*, 327 F.2d 797 (10th Cir. 1964).

In *Community TV*, the Tenth Circuit examined a 1959 amendment to an excise tax statute to find the meaning of the statute prior to the amendment. For purposes of taxing microwave transmissions, a 1958 transaction was before the court. Based upon a detailed comparison of prior statute and the 1959 amendment, the Tenth Circuit held that the 1958 transaction was not subject to tax.

This use of subsequent enactment to interpret current law was applied by this Court in *Hamilton*, *supra*. In interpretation of a statute enacted in *1869*, this Court in the majority opinion states that an act approved in 1896 ". . . bear[s] upon the proper construction of this section."

This Court in *Burke*, 112 S. Ct. 1869, examined the 1989 amendment to § 104(a)(2) to determine the meaning of the prior statute which applied when the case was brought in 1984. Justice Blackmun states:

> The enactment of this limited amendment addressing only punitive damages shows that Congress assumed that other damages (i.e. compensatory) would be excluded in cases of both physical and nonphysical injury.

In the concurrence, Justice Scalia, joined by Justice Souter, examined the 1989 amendment to § 104(a)(2) to clarify the prior law. Justice Scalia wrote:

> Congress amended § 104(a)(2), 1989, to provide prospectively that § 104(a)(2) shall not shelter from taxation "punitive damages in connection with a case not involving physical injury or physical sickness." As thus amended it is clear (whereas previously it was not) that "personal injuries or sickness" includes not only physical, but also psychological harm or disease; nevertheless, the amendment does not require the phrase unnaturally to be extended to injuries that affect neither mind nor body.

Burke, 112 S. Ct. at 1876, n. 3. The use of the later-enacted amendment, in an appropriate case, to illuminate the meaning of the prior statute is approved and demonstrated by this Court in *Hamilton* and *Burke*. **The use of a subsequent amendment to illuminate the meaning of a prior statute assures clear and consistent interpretation and application of that statute over time.**

The Tenth Circuit's offhand dismissal of the importance or significance of the "belief" of the Congress making the 1989 amendment is astonishing. The "belief of Congress" as to the meaning of statutes at the time they are enacting or amending those statutes is the essence of Congressional intent.

A subtle tendency pervades the decision of the Tenth Circuit that, in order to do good, the court will place the authority of the federal courts above the authority of Congress to make laws. Application of a "default rule" in favor of the government

instead of seeking the intent of Congress in the ample extrinsic evidence, the diminishment of the significance and authority of Congressional reenactment of the statute without material change from 1918 until 1989, the disregard of the strong Congressional policy, evident throughout Part III of the Code, to benefit the injured and bereaved, the willingness to eviscerate an actual Congressional amendment to the statute, are each evidence of this underlying tendency. Justice Louis Brandeis counsels vigilance against such encroachment:

> Experience should teach us to be most on our guard to protect liberty when the government's purposes are beneficent. Men born to freedom are naturally alert to repel invasion of their liberty by evil-minded rulers. The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-meaning but without understanding.

Olmstead v. United States, 277 U.S. 438, 471 (1928).

VI.

THE TENTH CIRCUIT HAS IMPERMISSIBLY EXPANDED THE POWER OF THE FEDERAL DISTRICT COURT TO MODIFY ITS JUDGMENTS BEYOND THE AUTHORITY GRANTED BY THE FEDERAL RULES OF CIVIL PROCEDURE.

There is no doubt that the government was entitled to the extended period of sixty (60) days under Fed. R. Civ. P. 4(a) in which to file its notice of appeal. However, the judgment from which it sought to appeal was filed on November 30, 1993, and was amended under Rule 60(a) on December 7, 1993. Amendment of a judgment under Fed. R. Civ. P. 60(a) does not

toll the time for filing the notice of appeal. The Tenth Circuit states without analysis or reference to statutory authority that the government's cross appeal is filed timely. *O'Gilvie*, 66 F.3d 1550 (10th Cir. 1995), 95-2 USTC ¶ 50,508. (Petition for Writ of Certiorari appendix at 8). Under no analysis is the Tenth Circuit correct in its holding.

Two questions had to be answered to determine jurisdiction. First, under what authority did the district court make its December 7, 1993 "amendment" to the judgment entered on November 30, 1993? Second, was the time for filing notice of appeal tolled under this authority?

The Federal Rules of Civil Procedure authorize the correction or amendment of a judgment in only certain instances: Rules 52, 59(e), 60(a), and 60(b). (Petition for Writ of Certiorari appendix at 41, 43, and 44). Rules 52, 59(e) and 60(b) require a motion by a party to amend a judgment. Rule 60(a) corrections may be made upon motion, but motion of a party is not required. No motion for amendment was made by either party. *Only* Rule 60(a) authorizes the correction of judgment on the court's own initiative. Such is the case here. In fact, the only errors in a judgment which a district court ***may*** correct of its own initiative are those errors arising from clerical mistakes and from oversight or omission as sanctioned by Rule 60(a). The court's omission in this case of the previously withdrawn decision in this case is the precise type of oversight or omission contemplated by Rule 60(a).

All parties were on prior notice of the decision of the court on that omitted portion of the November 30, 1993 decision. The court had issued **Judgment** on August 26, 1992 concerning the first issue which was withdrawn "subject to reinstatement at the conclusion of the case" on October 27, 1992. (Petition for Writ of Certiorari appendix at 30). The **Memorandum and Order**

filed with the **Judgment** on November 30, 1993 expressly stated in its introductory paragraph the result and holding of its clerical omission:

> In a previous opinion, this court held O'Gilvie's punitive damages award was excludable from income tax pursuant to § 104(a)(2) of the Internal Revenue Code.

(Petition for Writ of Certiorari appendix at 31). There was no doubt in the mind of the parties or the court that the district court had made a clerical error, nor was there any doubt concerning the substance of the court's decision.

Additionally, the decision in the November 30, 1993 **Judgment** was *absolutely dependent* upon the outcome of the first. The first determination, that punitive damages were excluded, was essential to the determination of the second issue of whether the "additional amount" was an additional punitive damage award and, therefore, also exempt from tax under § 104(a)(2). If the punitive damage award was taxable, then the "additional amount" would have been taxable in all events whether characterized as interest or additional punitive damage award. The parties were well aware that the decision in favor of the taxpayer on the first summary judgment issue of taxability of punitive damages was essential to the justiciability of the second summary judgment issue. The court's correction to include the omitted portion did not change the decision, but clarified what was understood by all parties to be what the court intended to say. *Blanton v. Anzolone*, 7 Fed. Rules Serv. 3rd 1461, 813 Fed. 1574 (9th Cir. 1987).

Rule 60(a) makes no provision for tolling the period of time for parties to file appeals because of the court's correction. *Miller v. Transamerican Press, Inc.*, 37 Fed. Rules Serv. 2d 850,

709 F.2d 524 (9th Cir. 1983). The district court corrected its omission on December 7, 1993 before either appeal was docketed in the appellate court.

The defendant's notice of appeal, filed on February 1, 1994, was filed more than sixty days from the date of final judgment on November 30, 1993. The court, on its own initiative under the authority of Rule 60(a), clarified what was understood by all parties to be what the court intended to say. Correction of the November 30, 1993 **Judgment** by the court on its own initiative under Rule 60(a) does not toll the period for filing an appeal. Defendant's appeal was not timely filed.

The determination by the Tenth Circuit that no statutory authority is required for amendment of a clerical error impermissibly expands the power and authority of the district court to alter and amend its decisions.

CONCLUSION

Petitioner Kelly M. O'Gilvie respectfully prays that this Court determine that the federal district court had authority to amend its judgment of November 30, 1993 on its own initiative exclusively under Federal Rule of Civil Procedure 60(a) and that because the Rule 60(a) does not toll the time for the IRS to appeal beyond 60 days, the notice of appeal filed by the IRS on February 1, 1994 was not timely filed, therefore, the Tenth Circuit did not gain jurisdiction to hear the appeal in *O'Gilvie*.

In the alternative, Petitioner respectfully requests that this Court find that the federal courts may not neglect their duty to fully interpret ambiguous federal statutes to determine the intent of Congress by resorting to a comprehensive review of all relevant extrinsic evidence. Additionally, the Petitioner asks that this Court find § 104(a)(2) to be structurally ambiguous and to

choose between the two competing interpretations. Petitioner request that this Court find that the words of the original statute unambiguously show the intent of the enactors of § 213(b)(6), precursor of § 104(a)(2), to exclude all damages, including punitive damages, received in a suit where the underlying claim is a personal injury tort, the death of the Petitioner's wife. The Petitioner asks the Court to properly weigh the significance of the following: (1) the plain meaning of the original statute; (2) Treasury Regulation § 1.104-1(c); (3) the long-standing administrative practice; (4) the repeated re-enactments and amendments by Congress where attention to the meaning of the statute was necessary and where Congress left the relevant language unchanged; and (5) the extensive caselaw rejecting the "compensatory purpose" test, to find that the intent of the enacting Congress was to exclude any damages, including punitive damages, received in a suit for personal injury, the death of the taxpayer's wife.

Petitioner requests that the issue of whether the "additional amount" awarded as the result of an improper remittur order is an additional punitive damages award and therefore excluded from taxation under § 104(a)(2) which issue was not reached by the Tenth Circuit Court of Appeals be remanded for decision on the merits and treated in accordance with the decision of this Court.

Respectfully submitted,

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